US Embassy Jakarta
ECONOMIC SECTION

Bank Indonesia's Open Market Operations

Updated August, 2005

- Open market operations are used by Bank Indonesia (BI) on a day-to-day basis to conduct monetary policy.
- Unlike most economies, which require injections of liquidity as they grow, Indonesia has suffered from excess liquidity since the financial crisis of 1997-98 since banks hold government bailout bonds but are reluctant to lend.
- BI now uses the "BI rate" as a reference rate for its one-month paper in the Indonesian Money Market.
- One-month Bank Indonesia Certificates (SBI) are auctioned weekly and three-month SBIs are auctioned monthly.
- BI also provides banks with a rupiah deposit facility (FASBI) for 1-14 days, and repo loans to banks using SBI as collateral.
- New short-term monetary expansion and contraction instruments (FTK and FTE) for fine-tuning liquidity were introduced in April.
- Please see www.bi.go.id for more information.

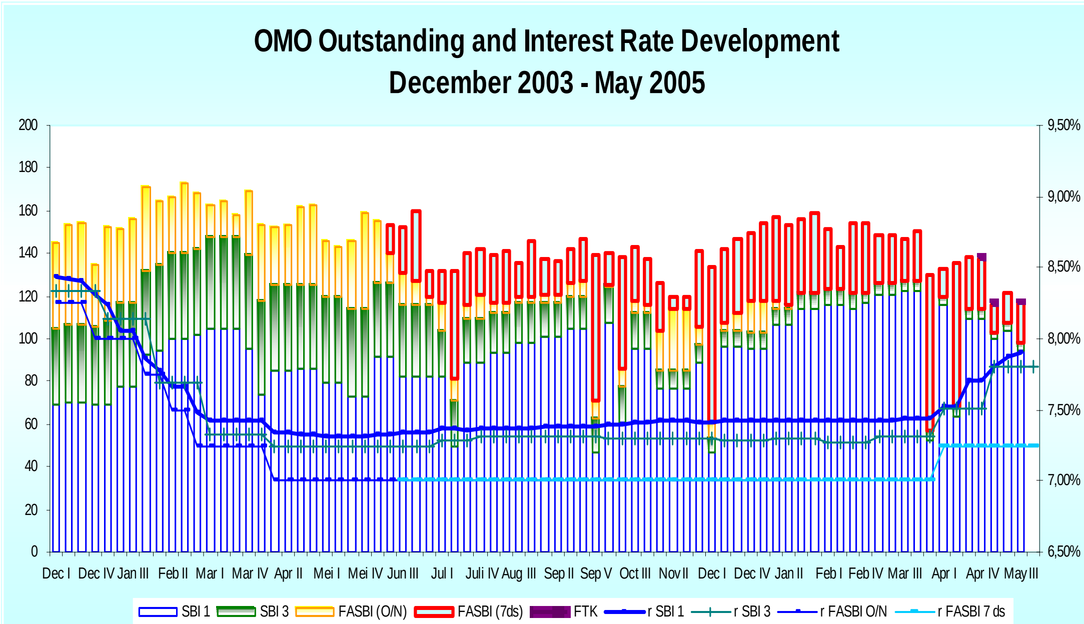
Tools and Operations

The central bank has four main tools for conducting monetary policy: open market operations, setting discount rates, setting the statutory reserve requirement, and regulating credit or financing. Open market operations are the tools used by Bank Indonesia (BI) on a day-to-day basis to absorb or provide liquidity to the market as needed. For example, if there is too much liquidity, BI will step in by either selling debt to the market or providing interest bearing accounts for banks to put their cash into.

Since growing economies require more cash, most central banks, such as the U.S. Federal Reserve, are continuously adding liquidity to the market. Indonesia, however, has experienced a "liquidity overhang" or too much liquidity in the system since the 1998 crisis, since banks hold government bailout bonds but are reluctant to lend. The liquidity overhang should decrease naturally over time, although it does sometimes constrain BI's ability to respond to macroeconomic shocks by limiting the amount of liquidity that can be added at any given time.

BI's conducts regular and irregular open market operations. Regular operations include one and three month SBI auctions, the FASBI deposit facility, SBI repos (repurchase agreements) and the SWBI, or Wadiah Certificate, which is an SBI using sharia principals. Irregular operations are Fine Tuning Operations (FTO).

Chart 1: OMO Activities, Outstanding and Interest rate Development (December 2003 – May 2005)



Source: Bank Indonesia

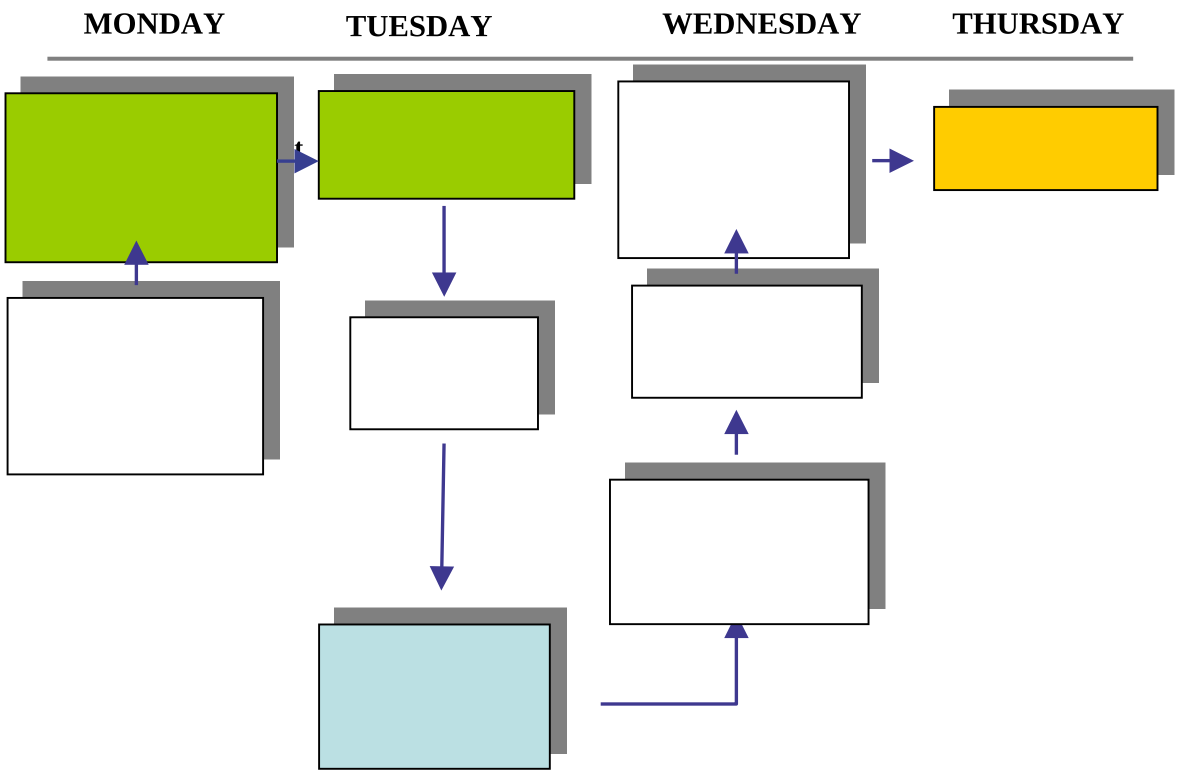
Bank Indonesia Certificates - SBI

Since the Indonesian government did not issue domestic debt to finance the budget prior to the 1998 crisis, BI began issuing its own debt in the form of Bank Indonesia Certificates (SBI) to manage the money supply in 1984. The one-month SBI is currently auctioned weekly and the three-month SBI is auctioned monthly.

BI announced in July 2005 that it would start using the "BI rate," or the reference rate for the one-month SBI auctions, as its operational target of monetary policy. The BI rate is set every three months in 25 basis point increments, but can be revised by BI in the interim, depending on the circumstances.

On August 30, 2005 BI raised its benchmark rate in a steeper increment of 75 basis points in light of rupiah-dollar exchange rate volatility. BI says it will continue to announce the target amount to be sold at one-month SBI auctions, despite the fact that it is difficult to target both the amount sold and the rate in an auction.

Chart 2: SBI Auction Process

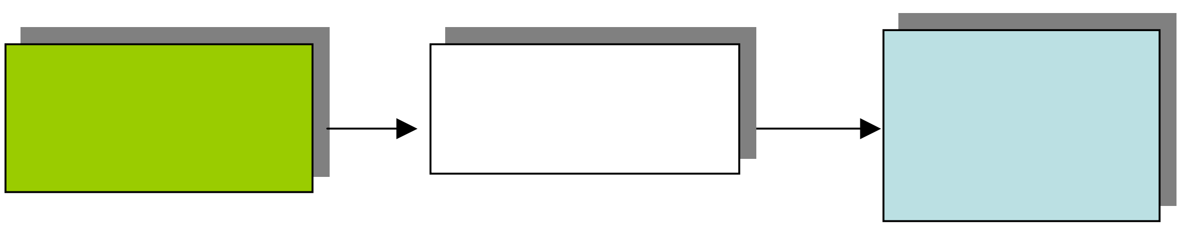


Source: Bank Indonesia

FASBI

The Fasilitas Bank Indonesia (FASBI) deposit facility is BI's rupiah deposit facility, in which banks can deposit funds with BI for one to 14 days and receive interest. (In many countries, this deposit rate is often used to set a floor for all other interest rates and acts as the central bank's discount rate.) BI previously offered only a seven-day FASBI with a set interest rate of 7.25%. Effective August 31, 2005 BI increased its FASBI interest rate by 100 bps to 8.5%. BI phased out an overnight FASBI window in January 2005. This has led to increased volatility in the overnight interbank rate, i.e., the rate at which banks lend to one another.

Chart 3: FASBI Process



Source: Bank Indonesia

Repo Instrument

BI also provides repos, or short-term loans to banks in exchange for SBIs. The SBIs act as collateral for the loan; when the loan matures, the bank repurchases the SBIs back from BI. BI phased out this instrument on August 22, 2005 and its function will be replaced by another expansion instrument called Fine-Tune Expansion (FTE).

The Master Repurchase Agreement, which was signed by five banks on June 15, 2005 allows market players to undertake repo transactions more freely. The central bank is still unable to provide reverse repos, since it holds a limited amount of government securities – just 7.4 trillion rupiah purchased in three operations in 2005 (April – August).

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Irregular Operations

The FTO was introduced in April 2005 and is used on an "as needed" basis for both monetary contraction (FTK) and expansion (FTE) purposes. These instruments can be used for one to 14 days, although so far BI has kept the maturities under one week. The FTK rate is fixed by BI and its cap is the one-week FASBI rate. The FTE would be a short-term lending facility to provide liquidity: only SBI and government bonds can be used as underlying assets for this transaction.